

## BRIEFING

# Budget support in EU development policy: An evolving framework

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Budget support involves direct financial transfers to partner countries. It also comprises policy dialogues, performance assessments and efforts to develop third countries' capacities.

Budget support is a form of aid that involves direct financial transfers to the national treasury of a partner country, as well as policy dialogue, performance assessment and capacity development. Some 20-25 % of total EU aid is provided through budget support. The current budget support policy was outlined in 2011 by a European Commission (EC) communication on its future approach to EU budget support ([COM\(2011\)638](#)) and in the related Council Conclusions ([9371/12](#)). Implementation has been promoted through dedicated [budget support guidelines](#) and a governance structure involving a Budget Support Steering Committee that provides high-level political and policy guidance. Regional hubs in Africa, Asia, Latin America and neighbourhood countries coordinate the aid.

## Overview of EU budget support policy and operations

The EU considers budget support a means of achieving development objectives and increasing aid effectiveness.

The EC states that budget support 'should not be seen as an end in itself, but as a means of delivering better aid and achieving sustainable development objectives' whilst increasing aid effectiveness. Within its overall objective of eradicating poverty, the EU considers budget support a 'vector of change' to address five specific development challenges:

- i) promoting human rights and democratic values;
- ii) improving public financial management, macroeconomic stability, inclusive growth and the fight against corruption and fraud;
- iii) promoting reforms in specific sectors and improving service delivery;
- iv) helping to build up the state in fragile states and addressing the challenges of Small Island Development States and overseas countries and territories (OCTs); and
- v) improving countries' efforts to mobilise domestic revenues and reduce their dependency on aid.

Three categories of budget support have existed since 2011:

- Good Governance and Development Contracts,
- Sector Reform Contracts, and
- State Building Contracts.

Eligible countries need to fulfil specific criteria to qualify for budget support.

Aid disbursements are linked to performance, which is monitored, and divided into base (or fixed) and variable (or performance) tranches.

Budget support disbursements in 2013 amounted to EUR 1.5 billion – 22 % of the EU's total aid disbursements.

There are 256 budget support programmes in 84 countries (2013).

Since 2011 budget support has been divided into three categories to better respond to the different contexts of partner countries<sup>1</sup>:

- **Good Governance and Development Contracts (GGDCs).**

These support broad reforms to strengthen governance mechanisms and improve domestic accountability, enabling poverty reduction and inclusive growth. Countries' commitment to fundamental values is a pre-condition and is monitored during the contracts' implementation.

- **Sector Reform Contracts (SRCs).**

These support sectoral policies and reforms and focus on equitable access and the quality of public service delivery. The countries' adherence to fundamental values is taken into account in awarding SRCs, but this is balanced against the need to provide basic services, particularly to the poor, women and children.

- **State Building Contracts (SBCs).**

These are awarded in situations of fragility which require action to support transition processes towards development and democratic governance. Fundamental values are taken into account, with a view to the future, and political dialogue is reinforced.

To be eligible for budget support, partner countries must have :

- i) national/sector policies and reforms that favour sustainable growth and poverty reduction;
- ii) a stable macro-economic framework;
- iii) strong public financial management, including mechanisms to fight against corruption and fraud;
- iv) transparency and oversight of the budget (this requirement was included only in 2011).

Budget support operations include a performance monitoring system that allows funds to be disbursed through base (or fixed) tranches – linked to eligibility criteria – and variable (or performance) tranches – linked to progress against specific indicators. The share of the variable tranche (averaging around 40 %) is balanced to provide incentives whilst avoiding excessive volatility; it also tends to be larger in countries with a poor track record or a higher risk assessment (*see below*).

Budget support disbursements in 2013 amounted to EUR 1.5 billion – 22 % of total EU aid disbursements<sup>2</sup>. Total commitments the same year stood at EUR 10.8 billion, with 256 budget support programmes in 84 countries: an average of EUR 130 million per country – although there are considerable regional differences. A huge majority (83 %) of programmes have a sectoral focus (SRCs and former sector budget support programmes), most often in the education sector; GGDCs represent only 5 % of total contracts and SBCs only 4 %. Africa (which is slated to receive

<sup>1</sup>Previously only two existed: general and sector budget support (GBS/SBS).

<sup>2</sup>Budget support financial implementation, risk assessment and selected macroeconomic and fiscal country results', DEVCO pilot report, 2013.

47 % of the total committed funds) and the EU's neighbourhood countries (29 % of committed funds) are the main recipient areas. Low-middle income countries receive 49 % of committed budget support funds, and low-income countries 28 %.

## Assessment of budget support and the European Parliament's position

The European Parliament recognises that budget support can provide predictable financial flows and increase aid effectiveness. The Parliament has also, however, highlighted certain risks in relation to this aid modality.

The EU's new budget support policy includes a more structured risk management framework that evaluates risks in five different categories: political, macroeconomic, development, public financial management and corruption/fraud.

Budget support operations have generated major debates about their benefits and risks. The European Parliament (EP) has addressed this subject on various occasions, including in its resolutions on budget support to developing countries ([2010/2300 \(INI\)](#)), on the Commission's 'Agenda for Change' ([2012/2002\(INI\)](#)) and on the 2012 discharge of the 8th, 9th and 10th European Development Funds ([2013/2206\(DEC\)](#)). The EP recognises that budget support can provide predictable financial flows and increase aid effectiveness by fostering domestic ownership of development policies, aligning donors' and national priorities and improving public financial management through policy dialogue and capacity building. Budget support operations can also enhance donor coordination (especially between the EU and Member States) and lead to increased transparency and accountability. However, the EP has also highlighted certain risks with budget support, including the difficulty of tracing EU funds once these are merged with national resources, and the related problem of assessing impact and mitigating the risks of misuse.

A 2010 [report by the European Court of Auditors](#) on EU general budget support called for the Commission to 'develop a sound risk management framework' (RMF) and for budget support programmes to recognise the 'specific circumstances and changing priorities of partner countries'. These recommendations – supported by the EP – were included in the EC new budget support policy. The policy created budget support contracts and includes a more structured RMF evaluating risks in five different categories (political, macroeconomic, development, public financial management and corruption/fraud) and providing an overall risk rating (low, moderate, substantial or high). An overview of this RMF, developed for the first time in 2013, shows that 27 % of countries are considered to have a generally 'substantial' risk, while no country was deemed 'high risk'. Corruption and fraud were prominent – present in 32 % of countries – as were developmental risks – present in 25 % of countries and dominated by the variability of government effectiveness. Political risks are dominated by challenges related to the rule of law. The EP (2013/2206) has highlighted these political risks and called on the EC to emphasise 'judiciary reform programmes'.

Overall, the EP has welcomed the new budget support policy's improved RMF and its greater focus on transparency, accountability and the fight against corruption. The Parliament has also continued to stress that budget support should be 'closely linked to the human rights record and

In the past decade the EU has provided budget support to countries that have experienced stronger economic growth and that have proven more resilient to economic downturns than other countries.

However, a causal link between budget support and poverty reduction cannot be established.

Controlling corruption has also improved, although it is relatively rare.

Effective parliamentary scrutiny, civil society's participation and a strong rule of law are fundamental to mitigating the risks of budget support operations and contribute to governance frameworks that reduce poverty and inequality.

governance situation of recipient countries' (2012/2002).

A summary overview of selected country results<sup>3</sup> shows that in the past decade the countries to which the EU has provided budget support have experienced stronger economic growth and been more resilient to economic downturns than countries with no EU budget support. EU-supported countries generally also have higher poverty rates and are successful in reducing poverty – although inequalities have not been reduced. Corruption controls in EU budget support countries have improved over the past decade – although they remain infrequent – while it has worsened in other aid recipient countries. Although these correlations exist, there is no clear causality.

A synthesis of budget support evaluations<sup>4</sup> from Tunisia, Mali, Zambia, Tanzania, South Africa, Mozambique and Morocco between 2010 and 2014 shows that budget support 'can achieve significant results within a diverse and often challenging set of contexts'. Budget support 'has contributed in important ways to upgrading the capability of these governments to manage their public finances, to deliver services and to regulate economic activity, for the benefit of their citizens', whilst 'none of the negative effects commonly assumed to be associated with budget support were found to be present'. The report noted 'significant reductions in income poverty in Mali, Morocco, South Africa and Tunisia, although it is difficult to attribute this directly to budget support'.

Budget support operations have undergone important changes since the EU started to use them in 2000. The establishment of a new budget support policy in 2011 addressed many – although not all – of the EP's requests, including risk management and linking budget support to respect of fundamental values. The recent results and evaluation of budget support operations are largely positive, even if a direct link between budget support and poverty reduction cannot be established. The new programming period in EU development assistance (2014-2020) provides a good opportunity for a more consistent and detailed evaluation of the impact of the new budget support contracts, notably GGDCs and SBCs. Furthermore, the EP has called for a greater involvement in the 'democratic monitoring of budgets by parliaments, courts of auditors, civil society and regional and local authorities in recipient countries' (2012/2002). Supporting effective parliamentary budgetary scrutiny, civil society organisations' participation in policy and budget processes, and a strong rule of law play fundamental roles in mitigating structural and long term risks to budget support operations and contributing to a transparent and accountable governance framework that, in turn, can promote sustainable development and the reduction of poverty and inequalities.

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<sup>3</sup> *Ibid.*

<sup>4</sup> 'Synthesis Analysis of the Findings, Conclusions and Recommendations of 7 Country Evaluations of Budget Support', Draft Report, September 2014.